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No. 02-1016

In the Supreme Court of the United States

LEE M. TILL AND AMY M. TILL,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

PETITIONERS' REPLY BRIEF ON THE MERITS

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QUESTIONS PRESENTED

Petitioners oppose Respondent's recasting of the "present value" or time value of money concept into an issue of "prevailing market rate."

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STATEMENT OF FACTS

Although the SCS allowed secured claim was projected to be paid within 17 months [Jt. App. 12 ¶ (c)(2)], the Trustee's records indicate that SCS received its initial distribution in August 2000, and that its allowed secured claim was paid in full (at 9.5% interest) on June 1, 2001 – within one year of the June 27, 2000 confirmation date. http://www.13network.com/indhome.htm.

Respondent did not admit the Retail Installment Contract into evidence in the Bankruptcy Court, and stood upon its witness's testimony that "Instant-Auto Finance [never] sells vehicles on credit other than to employees for a rate of interest less than 21 per cent [.]" (Jt. App. 47).

SUMMARY OF ARGUMENT IN REPLY

Respondent contends that state contractual or creditor-specific lending markets control the present value calculation, much like an extension of post-petition credit. Petitioners contend that the present value calculation under Chapter 13[1]

[1] The number of business reorganization filings in comparison to Chapter 13 filings is nominal [10,702 business Chapter 11s as compared to 451,258 total Chapter 13s reported for fiscal year 2002], http://www.uscourts.gov/judicialfactsfigures/table5.2.htm, and the monetary amounts at stake may justify higher costs of Chapter 11 administration. Unlike Chapter 13 with a standard 3-year and maximum 5-year term, Chapter 11 has no general term limitation and often involves no *periodic creditor payments which form the crux of the Chapter 13 present value analysis*. Under Chapter 11, confirmation discharges the debtor and frees the estate's property from all pre-petition claims. Should the plan fail, creditors may sue only on the obligations as stated in the plan, and pre-confirmation contracts are not revived. 3 Collier Bankruptcy Manual ¶ 1129.01[1] at 1129-3, 4 (3rd ed. rev. 1999). Under Chapter 11, the right

cramdown is not analogous to an extension of credit – it is neither consensual, contractual nor a loan – but exclusively a creature of statute to be determined in accordance with federal common or statutory law. The rates appropriate to the present value equation are easily accessed through market-sensitive national indices.

ARGUMENT IN REPLY

I. NATIONAL INDICES RATHER THAN STATE-LAW CONTRACT OR CREDITOR-SPECIFIC LENDING CRITERIA CONTROL

Respondent bears the "exceptionally heavy burden" of establishing that Congress intended to impose restrictions (e.g., "contract," creditor's "market rate") not appearing in the statutory text. *Patterson v. Shumate*, 504 U.S. 753, 754 (1992).

Respondent agrees that the concept of "present value" has a "well-recognized meaning[]" in common commercial parlance (i.e., time-value of money). (Resp. Br. 19). Petitioners contend that Congress was aware of this "well-recognized" meaning when the statute was enacted.

The dispute arises from the fact that the bankruptcy statute at § 1325(a)(5)(B)(ii) does not specify the manner in which the interest rate is to be determined. This is not the first time that federal courts have been met with the task of filling "gaps" in a comprehensive federal scheme such as the Bankruptcy Code.

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to adequate protection ends with confirmation, whereas relief under § 362(d) remains available to the Chapter 13 creditor post-confirmation. The complexity of assets (e.g., debt instruments or speculative business ventures) and variety of risks make the present value analysis as part of the "fair and equitable" standard under Chapter 11 a complex endeavor beyond the scope of consumer Chapter 13.

A federal statute may constitute a legitimate body of federal law which permits federal courts to employ federal law where the statute is silent on some key issue. John T. Cross, "Viewing Federal Jurisdiction Through the Looking Glass of Bankruptcy," 23 Seton Hall L. Rev. 530, 530-52 (1993).[2]

The "reasons which may make state law at times the appropriate federal rule," *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943), have been determined to be "singularly inappropriate" where application of state law would deal a serious blow to a federal congressional scheme, where state law is aberrant and does not provide appropriate standards for federal law, or where no overriding state interest is fulfilled by application of state law. *U.S. v. Little Lake Misere Land Co., Inc.*, 412 U.S. 580 (1973).

As explained by the Fifth Circuit in *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 793 F. 2d 1380 (5th Cir. 1986), *on reh'g*, 808 F. 2d 363 (1987) (en banc court reinstates panel opinion), *aff'd*, 484 U.S. 365 (1988):

> [T]he interest provisions of the Code and its predecessors, as interpreted by the Supreme Court for almost a century, are premised on the equitable principle that the unencumbered assets of a debtor's estate will not be used to benefit one class of creditors at the expense of another ....

793 F. 2d at 1387.

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[2] *Butner v. United States*, 440 U.S. 48 (1979), which held that property interests are created and defined by state law, is inapplicable to the present dispute, which does not involve creation or definition of a creditor's substantive property interests.

In the case of *Jones & Laughlin Steel Corp. v. Pfeiffer*, 462 U.S. 523, 547 (1983), this Court reversed the lower court's imposition of the state's "total offset" rule of discounting to present value, noting that the lower court had erroneously assumed that it was bound to apply a rule of state law as a "mandatory federal rule of decision." *Id.* at 524, 552 (*Cf*, deference afforded by the Seventh Circuit to state-law contract in the present case).

Bankruptcy courts must frequently look to other sources where the federal statute at issue does not define the applicable interest rate. Because Congress did not define "legal rate" at 11 U.S.C. § 726(a)(5), the Bankruptcy Appellate Panel in *Beguelin v. Volcano Vision, Inc.*, 220 B.R. 94 (9th Cir. BAP 1998) rejected the "state law approach," where the "legal rate" is based on state-law contract. The Court adopted the "federal law approach," applying the rate established by federal statute in the interest of equality of distribution, predictability, ease of administration, and use of federal law to decide a strictly federal issue. *Id.* at 99-100.

It has been said that "bankruptcy disputes are better characterized as *creditor-versus-creditor*.... **These are choices about distribution ..., and are not controlled by state law."** Were the debtor unable to abrogate its contracts, "some contract creditors may force performance on economically infeasible obligations. **Instead all contract partners face the same bankruptcy risk."** Elizabeth Warren, "Bankruptcy Policy," 54 Univ. Chi. L. Rev. 775, 785-86, 791, 810 (emphasis supplied).

As explained by this Court in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), the Bankruptcy Code has "reshaped debtor and creditor rights in a marked departure from state law....":

> The Code's cram down option **displaces a secured creditor's state-law right** to obtain immediate foreclosure upon a debtor's default. That change [is] ordered by federal law ....

520 U.S. at 954, 964 (emphasis supplied).

Respondent's failure to recognize this crucial state-federal law distinction causes Respondent to reach an erroneous result at odds with the bankruptcy statutes.

II. STATE-LAW CONTRACT IRRELEVANT

Remarkably, Respondent concedes that "... **section 1325(a)(5)(B)(ii) does not require** payment of the old contract rate." (Resp. Br. 38). Lenders acknowledge the Seventh Circuit's "presumption that the parties' contract rate of interest is the appropriate rate in cramdown," and conclude that "Lenders agree that the **statute does not require** any such formal presumption." (Amicus Br. 13).[3]

Neither Respondent nor Lenders grasp the significance of these admissions vis-a-vis plan confirmation. As noted by the Seventh Circuit in *Petro v. Mishler*, 276 F.3d. 375 (7th Cir. 2002):

> The Supreme Court has consistently held that Congress's use of the word 'shall' [§ 1325(a)] acts as a command to federal courts.... Furthermore, by creating a finite list of six affirmative requirements necessary for a plan's confirmation, we assume that Congress

[3] Ultimately Respondent and Lenders must admit that state contract rate is not an appropriate measure of present value – if only to circumvent the anomaly of outstanding loans at 0% APR.

> intended to exclude other requisites from being grafted onto section 1325(a).

276 F.3d at 378. *See also* S. Rep. No. 989, 95th Cong., 1st Sess. 141 (1978), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5927 (Congressional intent to fix a minimum of mandatory plan provisions).

It is thus apparent that the Seventh Circuit's imposition of a "rebuttable presumption" of contract rate was impermissible as a matter of law.[4]

Respondent is left with the untenable argument that "the contract rate and market rate are one and the same" (Resp. Br. 15) – an historically indefensible position. But Respondent needs a generic term to engraft onto § 1325(a)(5)(B)(ii), and "market rate" fits nicely with so many other concepts that Respondent found missing from the statute. (Resp. Br. 16).[5]

Respondent's arguments best demonstrate why confirmation standards cannot be controlled by generic terms like "market rate," nor permitted to take on whatever meaning a particular creditor or court chooses to ascribe.[6]

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[4] Respondent is left with nothing in the record to suggest that the plan failed to meet the statutory prerequisites for confirmation.

[5] The concepts that a creditor be "fully compensated" and receive the "full value of its interest or claim" derived from the "fair and equitable" standard for confirmation under Chapter XI that was reintroduced at 11 U.S.C. § 1129(b)(1) but never codified under Chapter 13. "Allocation of Corporate Reorganizations Between Chapters X and XI of the Bankruptcy Act," 69 Harv. L. Rev. 352, 355 (1955); *see also, In re Murel Holding Corp.*, 75 F. 2d 941 (2d Cir. 1935).

[6] The "market rate" analysis has been said to be "so elastic that it provides no guidance to the courts." "John K. Pearson et. al., "Ending the Judicial

Even though this language was never enacted under Chapter 13, Respondent maintains that these anachronisms control Chapter 13 present value interest rates.[7] As noted by the concurring opinion in *Bank of America National Trust & Savings Associate v. 203 North LaSalle St. P'ship*, 526 U.S. 434, 462 (1999), "... it makes little sense to graft onto the Code concepts that were developed during a quite different era of bankruptcy practice." *See Hartford Underwriters Insurance Co. v. Union Planters Bank*, 530 U.S. 1, 10 (2000) [pre-Code practice is a tool of construction, *not* an extra-textual supplement to the Bankruptcy Code].

Respondent's demand for collection of exorbitant subprime interest rates at the expense of other creditors in fact represents a striking departure from the pre-Code concept of equality of distribution. Long before the advent of subprime lending, this Court in *Nichols v. U.S.*, 384 U.S. 678 (1966), recognized:

> ... the inequity that would result if, through the continuing accumulation of interest in the course of subsequent bankruptcy proceedings, obligations bearing relatively high rates of interest were permitted to absorb the assets of a bankruptcy estate whose funds were already inadequate to pay the principal of the debts owed by the estate.

384 U.S. at 683 [now codified at 11 U.S.C. § 502(b)(2)].

Snipe Hunt: The Search for the Cramdown Interest Rate, 4 Am. Bankr. Inst. L. Rev. 35, 43 (1996).

[7] *See* Resp. Br. 42-43: SCS's treatment must be "completely compensatory" in exchange for deprivation of it's "non-bankruptcy collection entitlements."

A. Contract Not "Evidence" of Discount Rate

Lenders realize the fatal error in the Seventh Circuit's "rebuttable presumption" of contract rate (Amicus Br. 13), and awkwardly attempt to bypass the Court of Appeals by "agree[ing] fully with the district court in this case ...." *Id.* Lenders are more than a little disingenuous when they contend:

> .... The debtor's post-bankruptcy credit/risk profile warranted application of the rate dictated by the sub-prime market, and the court cited 'unrebutted evidence * * * that a subprime market exists and that its rate is 21%' [Pet. App.] at 38a. 'The fact that the contract rate is 21% [was] not controlling [on the] Court's decision. * * * .' *Ibid.*

Amicus Br. 13-14.

The record makes clear that there was no "*post-bankruptcy* creditor/risk profile." Nor does the Bankruptcy Code permit the debtor to be subjected to the type of "profiling" typical of pre-petition lending markets. This illustrates an abusive technique developed by "market-rate" proponents to graft onto the statutory requirements for confirmation, thereby **limiting debtor access** – in the same manner that a lender would deny the borrower a loan.

The justification for fixing of contractual interest rates is blurred in the inefficient sub-prime market.[8] Respondent

[8] The interest rate spread between the prime and subprime markets estimated at 196 basis points (1/100 of a percentage) has been attributed to the additional cost of servicing the subprime portfolio, difference in pre-petition risk, and subprime market inefficiency. OCC Working Paper, Comptroller of the Currency, Administrator of National Banks, Washington, DC "Economic Issues in Predatory Lending," July 30, 2003.

acknowledges that a contract rate of interest as high as 20% may be charged to "compensate [the lender] for having to investigate [the borrower], dun him for collection, and cover the risk premium from default and costly litigation." (Resp. Br. 21-22).

The contract rate consists of a host of factors — none of which have any bearing whatsoever on the delay and risk of nonpayment of the $4,000.00 allowed secured claim. The parties could not have contracted for this discount factor in advance, not only because the debtors' financial status (e.g., monthly payment obligations, budget, etc.) has been completely reconfigured by the reorganization, but also because protection against delay in nonpayment of the allowed secured claim could not have been bargained for at a time when the plan repayment terms were unknown. There is simply no applicable state law.

Lenders argue that any changes in the debtor's pre-petition credit/risk profile as the debtor is reorganized are the proper subject of proceedings before the bankruptcy court, and the contract rate is "potentially an important piece of evidence" (Amicus Br. 12-13). Under Rule 401 of the Federal Rules of Evidence applicable in bankruptcy cases," '[r]elevant evidence' means evidence having any tendency to make the existence of any fact that is of consequence to the determination ... more probable or less probable than it would be without the evidence." Lenders make no attempt to suggest how the pre-

Market inefficiency results from the fact that subprime borrowers commonly purchase more expensive credit (above market rates unsupported by risk characteristics of borrowers) when less expensive credit is available. Subprime lenders too often compete with each other not by offering lower rates, but by relying on more aggressive sales techniques. Kurt Eggert, "Held Up in Due Course: Predatory Lending, Securitization and the Holder in Due Course Doctrine," 35 Creighton L. Rev. 503, 638-39 (April 2002).

petition contract rate — which measures entirely different variables — has any relevance whatsoever to the limited scope of the statutory present value calculation.[9]

Both Respondent and Lenders proceed on the assumption that the statutory rate is controlled by whatever the lender could extract from the borrower under the state-law contract. Lenders conclude that a range of "...100% - 300% ... would have the same grounding in the text of the Bankruptcy Code: none." (Amicus Br. 14). This rationale misapprehends the present value function of § 1325(a)(5)(B)(ii) to a dangerous extreme.

B. State Contract and Creditor-Debtor Specific Criteria Defeat Uniform Application of Confirmation Standards

Respondent contends that, "[l]ike 506(b), section 1325(a)(5)(B) operates to preserve for the secured creditor the 'value of its economic bargain.'" (Resp. Br. 38). This statement betrays a misunderstanding of the distinct purposes of the two sections. Section 506(b) permits oversecured claims to accrue pre-confirmation or *pendency* interest *only* up to the value of the creditor's collateral, and thus does not deplete funds otherwise payable to unsecured creditors.[10] Section

[9] Lenders attempt to do indirectly what they cannot do directly. Recognition that state contracts are not "evidence" of present value under § 1325(a)(5)(B)(ii) is critical to any effective resolution of this issue. If state contract is proper "evidence" of present value, those Circuits that have adopted contract rate without proper analysis will likely continue to do so under the guise that state contract represents "evidence" which the debtor is unable to counter; the door then remains open to introduction of debtor-creditor specific lending criteria, and the bankruptcy judges are placed in the position of unwilling loan officers.

[10] Contrary to Respondent's assertion (Resp. Br. 37), § 506(b) does not mandate interest at the contract rate for oversecured creditors, *United States*

§ 506(b) thus serves the function of defining a creditor's substantive claim. In sharp contrast, post-confirmation or *plan* interest merely preserves the status quo, and ensures that the allowed secured claim *as determined under § 506* is paid at present value.

Respondent contends that adequate protection "preserve[s] the secured party's position up to the point of confirmation," and concludes from there that Congress could not have intended to impose a substandard post-confirmation interest rate. (Resp. Br. 37). Again, Respondent misinterprets the concept of adequate protection. This Court in *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988), made clear that nebulous phrases such as "indubitable equivalent" and "benefit of the bargain" do not protect the undersecured creditor's pre-confirmation financial position (e.g., profit). Respondent's reliance upon the legislative history of § 361 is therefore misplaced.

Nor can Respondent conform its lender-specific approach with other confirmation sections employing identical language. Despite Respondent's concession that § 1325(a)(4) requires a similar discounting of plan payments to present value and the fact that "each allowed unsecured claim[ant]" may have a different contract rate of interest, Respondent contends that the

v. Ron Pair Enter., Inc., 489 U.S. 235 (1989), although courts have discretion to permit interest at the contract rate (consistent with pre-Code practice as to *oversecured* claims) – but only to the extent that the value of the collateral exceeds the amount of the secured claim. Under Respondent's analysis, interest at the contract rate that is no longer payable to an oversecured creditor under § 506(b) can be resumed under § 1325(a)(5)(B)(ii), thereby counteracting the limitations of § 506(b). Or interest at a contract rate of 30% could be paid under § 1325(a)(5)(B)(ii) on top of interest at the contract rate of 30% that had accrued and become a part of the claim under § 506(b).

court need only select one undefined "market rate for unsecured loans." (Resp. Br. 39). If this appears inconsistent with Respondent's analysis at § 1325(a)(5)(B)(ii), one can take comfort in Respondent's assurance that **"[t]he discounting procedure under section 1325(a)(4)... is rarely (if ever) employed"** (emphasis supplied).[11]

III. PROTECTION LIMITED TO VALUE OF COLLATERAL

Respondent and Lenders cannot accept the fact that § 1325(a)(5)(B)(ii) protects the value of the collateral – nothing more. Respondent objects that "... the secured creditor's collateral often proves inadequate to cover completely the creditor's secured claim, let alone its collection costs." (Resp. Br. 29). As stated by the Supreme Court in *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940):

> .... Safeguards were provided to protect the rights of secured creditors ... to the extent of the value of the property .... There is no constitutional claim of the creditor to more than that. And so long as that right is protected the creditor certainly is in no position to insist that doubts or ambiguities in the Act be resolved in its favor and against the debtor.

311 U.S. at 278-79.[12]

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[11] Had Respondent simply acknowledged that applying each creditor's state-law contract rate in the context of federal statutory present value does not work, § 1325(a)(4) would not have been rendered obsolete.

[12] Lenders stress that '[t]rading in claims of bankrupt concerns' is a 'multi-billion dollar market.' (Amicus Br. 6, n. 3). Presumably this is a part of the "economic value of its bargain" that debtors must shoulder under the guise of "market rate." The Code does *not* require that the lender be able to sell its bankruptcy claim on the open market. The "investment band approach" urged by Lenders (Amicus Br. 10) equates debt and equity in arriving at a "market rate of interest." A stock investor in a corporation normally is not offered a stream of payments (typical of Chapter 13), but has instead placed its capital at risk in anticipation of an increase in value of its investment over time. To argue that the Code requires a lender to obtain the return that an equity investor would require gives the lender the benefit of a stream of payments as well as the type of exaggerated returns enjoyed by investors who risk a total loss without the benefit of any collateral – another distortion of the present value concept by use of the nebulous "market rate" – again to the serious detriment of unsecured creditors.

Respondent is forever stuck in nonbankruptcy state law when it insists upon the "full economic value of its bargain" and realization of the "economic return" from its collateral. (Resp. Br. 38). Neither Respondent nor Lenders provide the slightest authority for the contention that *upon confirmation of a Chapter 13 plan*, a higher rate of interest is required to protect the subprime lender's allowed secured claim than is required to protect the prime lender's claim. For purposes of § 1325(a)(5)(B)(ii), it makes no difference whether the $4,000 allowed secured claim is held by a creditor who had the pre-petition status of a prime or subprime lender — or whether the claim originated with a debtor who was single with no established credit line.

Respondent's reliance on data (Resp. Br. 25) concerning "filed" Chapter 13 cases that fail to complete is highly misleading and unrepresentative of the *confirmed* plans that *do* complete. Other studies support a finding that a majority of plans that have been confirmed *are* successfully completed. *See, e.g.*, Marjorie L. Girth, "The Role of Empirical Data in Developing Bankruptcy Legislation for Individuals," 65 Ind. L. J. 17, 40-42 (1989) [finding completion rate of 63% in area-wide sample of *post-confirmation* Chapter 13 cases]. Secured claimants fare quite well even in uncompleted Chapter 13s,

because allowed secured claims are much more likely to be paid than are wholly unsecured claims.[13] If a Chapter 13 debtor defaults after confirmation and *prior* to payment of the allowed secured claim, the creditor still reserves all state-court collection rights as to the collateral and collection of deficiency.[14] Assuming *in arguendo* that the overall Chapter 13 failure rate is undesirably high, and given the fact that Congress intended to promote the use of Chapter 13, it makes little sense to increase the debtors' burden by imposing excessive interest rates not mandated by the Code. Finally, if the failure rate of Chapter 13 provides a measure for interest under § 1325(a)(5)(B)(ii), *all* secured claimants would be entitled to exorbitant interest rates – not just subprime lenders – further depleting distributions to unsecured creditors.

The different rates assigned to different creditors in this case derived from the fact that the contractual interest rates were modified under § 1322(b)(2), and the fact that the plan need not pay a secured creditor's claim at present value if the creditor has accepted the plan pursuant to § 1325(a)(5)(A).

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[13] *See, e.g.*, Scott F. Norberg, "Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13," 68 Am. Bankr. Inst. L. Rev. 415, 418, 438-39 (1999) [expressing concern for shift of more dollars from unsecured to secured creditors, noting that approximately 90% of all Chapter 13 payments (excluding attorney's fees) went to secured creditors].

[14] Respondent complains that upon payment of the allowed secured claim with interest, a creditor may be required to relinquish its lien on the collateral, although this is merely a function of the fact that § 1325(a)(5)(B)(ii) protects the creditor *only* to the extent of the allowed value of the collateral. *See, e.g.*, "...Of course, the secured creditor's lien only secures the value of the collateral and to the extent property is distributed of a present value equal to the allowed amount of the creditor's secured claim the creditor's lien will have been satisfied in full..." 124 Cong. Rec. H11107 (Sept. 28, 1978); S17423 (Oct. 6, 1978).

Contrary to Respondent's attempted comparison (Resp. Br. 49), the plan's reduction of the other secured claimants' contractual interest rates resulted in *increased* distributions to unsecured claimants.

Respondent ignores the glaring inequity of distribution to unsecured claimants that underlies its position, declaring that it has no duty to "subsidize" debtors (Resp. Br. 44). Respondent fails to appreciate the fact that § 1325(b)(1) requires, upon objection, that the debtor contribute all projected disposable income for a minimum three-year term – eliminating the so-called debtor "windfall."[15] The preferential treatment of one class of creditors (e.g. subprime lenders) in fact requires other creditors to "subsidize" the inefficient subprime market.

Respondent incredulously suggests that profit rates are no higher for subprime lenders than for lenders in traditional markets (Resp. Br. 48). Most analysts agree that subprime loans are extremely profitable, as demonstrated by the influx of traditional prime lenders into the subprime market – tapping ever deeper into the borrower pool. By charging interest rates to 25%, several subprime lenders have reported profit margins of 23% to 41%. "Life After Mercury: How to Pick a 'Safe' Used-Car Lender," Financial World, May 20, 1997 at 40.[16]

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[15] "Congress frequently rewards certain individuals and groups ... with favorable rates. Debtors under Title 11 of the United States Code are among those singled out for special treatment." *In re Dingley*, 189 B.R. 264, 270, n. 6 (Bankr. N.D.N.Y. 1995). *See also Timbers, supra*, 484 U.S. at 379 ("That secured creditors do not bear one kind of reorganization cost hardly means that they bear none of them").

[16] Subprime companies also rely on a practice known as "securitization" – a process in which the lender repackages pools of loans as securities and sells them to investors. This process provides the subprime lender with a revolving source of capital with which to make new loans, and the investor

Both Respondent and Lenders contend that because the Court adopted a market-based valuation standard in *Rash*, *supra*, the Court must adopt a market-rate interest standard for computing present value – an apples and oranges comparison, similar to Respondent's contention that "market rate" equals "contract rate." The valuation determination in *Rash* was necessarily *collateral specific*, based upon the quality of particular collateral under § 506(a). But once a value is established for the collateral under § 506(a), present value under § 1325(a)(5)(B)(ii) merely preserves the value of the fixed claim amount. Further, the *Rash* valuation was premised on the fact that the debtor had *not* surrendered the property, *Id*, whereas the analysis of the Seventh Circuit below proceeded as though the debtor *has* surrendered the collateral (and that the creditor has reinvested the proceeds at a healthy profit).[17]

Respondent contends that society will be overwhelmed by the loss that must be absorbed in the event its pre-petition interest rate is adjusted. Respondent's predictions of economic doom are not well-taken.[18] Nor has Respondent cited any

– rather than the original lender – thus bears the risk of borrower default. Evan M. Gilreath, "The Entrance of Banks Into Subprime Lending: First Union and The Money Store," 3 N.C. Banking Inst. 149, 152-53 (1999).

[17] The Court in *Rash* adopted the Ninth Circuit's interpretation of fair-market value in *In re Taffi*, 96 F. 3d 1190, 1191-92 (9th Cir. 1996) (en banc), *cert. den.*, 521 U.S. 1103 (1997). 520 U.S. at 959, n.2. The Ninth Circuit in *In re Fowler*, 903 F. 2d 694, 698-99 (9th Cir. 1990), determined that the bankruptcy court did not err in use of a formula approach for determining cramdown interest (prime rate on the date of plan confirmation plus .75% risk factor; court remanded for additional fact-finding on risk). There is no inconsistency between use of a national index in conjunction with the *Rash* valuation standard.

[18] Studies on the effect of sending more debtors to Chapter 13 (as opposed to Chapter 7) estimate that the increased repayment of consumer debt would allow creditors to reduce interest rates by a trivial 0.08%- 0.43%. 37 Wake

authority evidencing an increase in Chapter 13 filings, nor a decrease in credit availability, in Circuits rejecting state-contract rates. When bankruptcy law rehabilitates debtors, it resurrects their contribution to supply and demand. Indeed, the right to a fresh start is recognized as one of the "principal productivity restoring functions" of bankruptcy law. Nicholas L. Georgakopoulos, "Bankruptcy Law for Productivity," 37 Wake Forest L. Rev. 51, 66, 94 (2002).

IV. THE FEDERAL-LAW APPROACH

Appropriate federal guidelines can thus be established for calculating present value at § 1325(a)(5)(B)(ii), and many of the alternatives that have been used in the past can be eliminated. Certain rates may be rejected because they are not sufficiently market-sensitive (i.e., not adjusted with sufficient frequency). Certain calculations are too complex and unsuited to the limited assets involved in Chapter 13 (e.g. investment band or weighted average approach of Chapter 11). The contract rate and creditor-debtor specific market rates applied by the District Court and Seventh Circuit below are improperly tied to irrelevant pre-petition state-law lending criteria.

In *Pfeifer*, *supra*, 462 U.S. at 552, this Court did not adopt a single national rate nor require 'delusive exactness.' The Court concluded that a court employing a "real interest rate" approach (for determining present value of lost earnings in suit under federal maritime statute) should not be reversed if it adopts a rate between 1-3% and explains its choice. *Id.* at 548.

Forest L. Rev., *supra* at 60, n.18, *citing* Federal Reserve Statistical Release, Consumer Credit, available at http://www.federalreserve.gov/releases/G19/hist/cc_hist_sa.html. Respondent cannot seriously contend that "full payment" is the norm outside Chapter 13 (Resp. Br. 46).

Petitioners have argued for a rate pegged to a readily accessible (national) market index as a default rate for selecting discount rates under § 1325(a)(5)(B)(ii).[19]

Outside the bankruptcy context, application of the prime rate has been adopted by various federal courts in cases where there is no statutory interest rate to compensate for both loss of use of money and risk of payment default. *See, e.g., Gorenstein Enterprises, Inc. v. Quality Care-USA, Inc.*, 874 F. 2d 431, 436-37 (7th Cir. 1989) [recommending that federal court in trademark infringement case use the prime rate for fixing prejudgment interest where there is no statutory rate because it is a "readily ascertainable figure which provides a reasonable although rough estimate of the interest necessary to compensate plaintiffs not only for the loss of use of their money but also for the risk of default"].

In other federal case contexts where the issue has arisen, a national index rate was thus adopted, and prime rate was considered sufficient to compensate *both* for delay in payment and risk of default. Given costs and other charges included in prime rate inappropriate in the bankruptcy context, use of prime rate should *not* necessitate an additional risk premium.

There is convincing authority for use of Treasury securities as a base rate. The Federal Reserve issues securities of every maturity spectrum on a regular basis. As a result, the interest rates on Treasury securities are commonly accepted as

[19] Although certain of Petitioners' amici have proposed one index for all cases, Petitioners and amici are substantially consistent in their proposed pegging of the rate to a readily accessible federal or national market independent of debtor-creditor specific characteristics. *See* accompanying Addendum for interest rates and bond yields reported by the U.S. Census Bureau in Statistical Abstract of the United States: 2002 (U.S. Department of Commerce) for periods of 1980 - 2001.

benchmark rates in the U.S. economy. Aaron J. Bell, "Making Cramdown Palatable: Post-Confirmation Interest on Secured Claims in a Chapter 11 Cramdown," 23 Willamette L. Rev. 405, 434 (1987). The appropriate Treasury instrument corresponding to the plan term could thus easily be selected as a base; because government securities are now indexed to inflation, it has been recommended that courts take judicial notice of this market in determining present value.[20]

Discounting of future damage awards to present cash value in federal tort cases does not account for any additional risk associated with distribution of a stream of payments over time. The term "risk-adjusted" discount rate has been defined as "the rate necessary to determine the present value of an uncertain … stream of income; … the risk-free rate (generally the return on short-term U.S. Treasury securities) plus a risk premium…." John Downes and Jordan Elliott Goodman, Dictionary of Finance and Investment Terms 594 (6th ed. 2003). The Treasury security rate would thus be appropriate in routine Chapter 13 cases where no additional risk factor is necessitated, or in any Chapter 13 case as a base rate.[21]

[20] One study found that only in the case of U.S. Treasury bills do data result in an average rate that, when adjusted for inflation, approximates the 2% mid-range real interest rate standard approved by *Pfeifer*, and that only in the case of Treasury bills are the average returns less than 2% above the rate of inflation. Ward S. Curran, "Present Value Analysis in Estimating Damages in Torts," 72 Conn. Bar J. 375, 399, 405 (1998).

[21] Respondent failed to demonstrate any *post-confirmation* risk to its collateral not protected by adequate protection of its fully secured lien, the *Rash* higher valuation standard, periodic wage-assignment payments, the Court's feasibility determination, and SCS's entitlement to prompt relief from stay for reinstatement of state-law collection rights had the debtors defaulted prior to full payment of the allowed secured claim with interest.

The federal-law approach adopted by the bankruptcy court must not include improper elements of compensation. It should be readily accessible, inexpensive to calculate, easily applied, and should ensure that the burden of payment does not fall disproportionately upon the debtors or other creditors.

CONCLUSION

For the foregoing reasons and those stated in Petitioners' opening brief, Petitioners respectfully request that the judgment of Court of Appeals be reversed.

Respectfully Submitted,

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No. 1168. Money Market Interest Rates and Mortgage Rates: 1980 to 2001

[Percent per year. Annual averages of monthly data, except as indicated]

Type	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Federal funds, effective rate	13.35	8.10	8.10	5.69	3.52	3.02	4.21	5.83	5.30	5.46	5.35	4.97	6.24	3.88
Prime rate charged by banks	15.26	9.93	10.01	8.46	6.25	6.00	7.15	8.83	8.27	8.44	8.35	8.00	9.23	6.94
Discount rate [1]	11.77	7.69	6.98	5.45	3.25	3.00	3.60	5.21	5.02	5.00	4.92	4.62	5.73	3.40
Eurodollar deposits, 3-month	14.00	8.27	8.16	5.86	3.70	3.18	4.63	5.93	5.38	5.61	5.45	5.31	6.45	3.70
Large negotiable CDs:														
3-month, secondary market	13.07	8.05	8.15	5.83	3.68	3.17	4.63	5.92	5.39	5.62	5.47	5.19	6.35	3.71
6-month, secondary market	12.94	8.24	8.17	5.91	3.76	3.28	4.96	5.98	5.47	5.73	5.44	5.33	6.46	3.66
Taxable money market funds [2]	12.68	7.71	7.82	5.71	3.36	2.70	3.75	5.48	4.95	5.10	5.04	4.64	5.89	3.67
Tax-exempt money market funds [2]	(NA)	4.90	5.45	4.13	2.58	1.97	2.38	3.39	2.99	3.14	2.94	2.72	3.54	2.24
Certificates of deposit (CDs): [3]														
6-month	(NA)	8.05	7.79	5.80	3.51	2.88	3.42	4.92	4.68	4.86	4.58	4.27	5.09	3.43
1-year	(NA)	8.53	7.92	6.03	3.78	3.16	4.01	5.39	4.95	5.15	4.81	4.56	5.46	3.60
2½-year	(NA)	9.32	7.96	6.46	4.56	3.80	4.58	5.69	5.14	5.40	4.93	4.74	5.64	3.97
5-year	(NA)	9.99	8.06	7.02	5.76	4.98	5.42	6.00	6.46	5.66	5.08	4.93	5.97	4.58
U.S. Government securities:														
Secondary market: [4]														
3-month Treasury bill	11.39	7.47	7.50	5.38	3.43	3.00	4.25	5.49	5.01	5.06	4.78	4.64	5.82	3.40
6-month Treasury bill	11.32	7.65	7.46	5.44	3.54	3.12	4.64	5.56	5.08	5.18	4.83	4.75	5.90	3.34
1-year Treasury bill	10.85	7.81	7.35	5.52	3.71	3.29	5.02	5.60	5.22	5.36	4.80	4.81	5.78	3.84
Auction average: [5]														
3-month Treasury bill	11.51	7.47	7.51	5.42	3.45	3.02	4.29	5.51	5.02	5.07	4.81	4.66	5.85	3.45
Home mortgages:														
New-home mortgage yields [6]	12.70	11.60	10.05	9.32	8.24	7.20	7.49	7.87	7.80	7.71	7.07	7.04	7.52	7.00
Conventional, 15 yr. fixed [3]	(NA)	11.48	9.73	8.76	7.80	6.65	7.77	7.39	7.28	7.16	6.58	7.09	7.76	6.53
Conventional, 30 yr. fixed [3]	(NA)	11.85	9.97	9.09	8.27	7.17	8.28	7.86	7.76	7.57	6.92	7.46	8.08	7.01

NA Not available. [1] Rate for the Federal Reserve Bank of New York. [2] 12 month return for period ending December 31. Source: iMoneyNet, Inc., Westborough, MA, *Money Market Insight*, monthly, <http://www.imoneynet.com> (copyright). [3] Annual averages. Source: Bankrate, Inc., North Palm Beach, FL, *Bank Rate Monitor*, weekly (copyright). [4] Averages based on daily closing bid yields in secondary market, bank discount basis. [5] Averages computed on an issue-date basis; bank discount basis. Source: U.S. Council of Economic Advisors, *Economic Indicators*, monthly. [6] Effective rate (in the primary market) on coventional mortgages, reflecting fees and charges as well as contract rate and assumed, on the average, repayment at end of ten years. Source: U.S. Federal Housing Finance Board, *Rates & Terms on Conventional Home Mortgages, Annual Summary*.

Source: Except as noted, Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, monthly.

No. 1169. Bond Yields: 1980 to 2001

[**Percent per year**. Annual averages of daily figures, except as indicated]

Type	1980	1985	1990	1994	1995	1996	1997	1998	1999	2000	2001
U.S. Treasury, constant maturities: [1] [2]											
1-year	12.00	8.42	7.89	5.32	5.94	5.52	5.63	5.05	5.08	6.41	3.49
2-year	11.73	9.27	8.16	5.94	6.15	5.84	5.99	5.13	5.43	6.26	3.83
3-year	11.51	9.64	8.26	6.27	6.25	5.99	6.10	5.14	5.49	6.22	4.09
5-year	11.45	10.12	8.37	6.69	6.38	6.18	6.22	5.15	5.55	6.16	4.56
7-year	11.40	10.50	8.52	6.91	6.50	6.34	6.33	5.28	5.79	6.20	4.88
10-year	11.43	10.62	8.55	7.09	6.57	6.44	6.35	5.26	5.65	6.03	5.02
20-year	(NA)	(NA)	(NA)	7.47	6.95	6.83	6.69	5.72	6.20	6.23	5.63
30-year	11.27	10.79	8.61	7.37	6.88	6.71	6.61	5.58	5.87	5.94	5.49
U.S. Govt., long-term bonds [2] [3]	10.81	10.75	8.74	7.41	6.93	6.80	6.67	5.69	6.14	6.41	(NA)
State and local govt. bonds, Aaa	7.86	8.60	6.96	5.78	5.79	5.52	5.32	4.93	5.29	5.58	4.99
State and local govt. bonds, Baa	9.02	9.59	7.30	6.18	6.05	5.79	5.50	5.14	5.70	6.19	5.75
Municipal (Bond Buyer, 20 bonds)	8.55	9.11	7.27	6.19	5.95	5.76	5.52	5.09	5.43	5.71	5.15
Corporate Aaa seasoned [4]	11.94	11.37	9.32	7.96	7.59	7.37	7.26	6.53	7.05	7.62	7.08
Corporate Baa seasoned [4]	13.67	12.71	10.36	8.62	8.20	8.05	7.86	7.22	7.88	8.37	7.95
Corporate seasoned, all industries [4]	12.75	12.05	9.77	8.25	7.84	7.67	7.53	6.87	7.45	7.98	7.49

NA Not available. [1] Yields on the more actively traded issues adjusted to constant maturities by the U.S. Treasury. [2] Through September 1996, yields are based on closing bid prices quoted by at least five dealers. Beginning October 1996, yields are based on closing indicative prices quoted by secondary market participants. [3] Averages (to maturity or call) for all outstanding bonds neither due nor callable in less than 10 years, including several very low yielding "flower" bonds. [4] Source: Moody's Investors Service, New York, NY.

Source: Except as noted, Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, monthly.